
Senate Budget and Fiscal Review—Wesley Chesbro, Chair
SUBCOMMITTEE NO. 1 on Education



Subcommittee No. 1
Chair, Jack Scott
Member, Bob Margett
Member, Joe Simitian

OUTCOMES

May 1, 2006
1:30 pm – Room 4203

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I. California Department of Education (Item 6110)

A. Instructional Materials and State Board of Education

The Governor's Budget proposes **\$402 million** in Proposition 98 funding for the Instructional Materials Block Grant in 2006-07, which provides a **\$40 million** (11 percent) increase over the 2005-06 level of funding. The Governor's budget also includes an estimated **\$190 million** in State Lottery funds for K-12 schools in 2006-07, which reflects a **\$40 million** increase in lottery revenues beginning in 2005-06 that must be used for instructional materials. The LAO recommends that the Legislature reject the \$40 million Proposition 98 increase considering the \$40 million in new lottery revenues available to schools for instructional materials in 2006-07.

Background. The Instructional Materials Block Grant program provides funding to school districts for the purchase of standards-aligned instructional materials for students in grades K-12. Funding is allocated to districts on the basis of the number of enrolled students in grades K-12.

Proposition 20, which was passed by voters in 2000, requires that 50 percent of lottery revenue growth be utilized for purchase of instructional materials by K-12 schools and community colleges. There is no requirement that instructional materials purchased with state lottery funds be aligned to state curriculum standards. Lottery funds are not appropriated through the budget, but continuously appropriated.

Governor's Budget. The Governor proposes a total of **\$592 million** for instructional materials, which includes **\$402 million** in Proposition 98 funding and **\$190 million** in State Lottery Funds in 2006-07.

The Governor's budget proposes a total funding level of **\$402 million** for the state Instructional Materials Block Grant, which provides funding to school districts to purchase standards-aligned materials. This is an increase of \$41 million over last year's funding level of which approximately half is attributable to growth and COLA and half reflects an increase in the program base.

According to the LAO, total funding available for instructional materials has increased significantly in recent years, as indicated in the following table from their analysis.

<i>(Dollars in Millions)</i>				
	2003-04	2004-05	2005-06	2006-07
Instructional Materials Block Grant	\$175	\$333	\$361	\$402
Lottery funds for Instructional materials	115	150	190 ^a	190 ^a
Totals	\$290	\$483^b	\$551	\$592
Year-to-year change	—	66%	14%	7%
a LAO estimates based on lottery revenue projections.				
b In addition to the figure shown here, \$168 million in one-time funding was provided in this year.				

Williams Settlement. The *Elizier Williams v. State of California* (Williams) lawsuit settlement agreements, which were approved by the courts in 2004, address student access to qualified teachers, instructional materials and clean and safe school facilities. The 2004-05 budget package included \$188 million in one-time funding specifically for the Williams settlement agreements relating to instructional materials. These funds, as appropriated and further specified in Chapter 900, Statutes of 2004, include:

- \$138 million in one-time funding for instructional materials for students in Deciles 1 and 2 of the Academic Performance Index (API).
- \$15 million for county office of education oversight and monitoring of schools in Deciles 1 -3 to assure for teacher misassignment, condition of school facilities, and adequacy of instructional materials.
- \$5 million to the CDE for the purchase of textbooks. These funds were an advance to be repaid by districts.

The Governor's 2006-07 budget does not provide additional instructional materials funds for Decile 1-3 schools. However, the budget does propose to continue funding for support of county office oversight and monitoring of Decile 1-3 schools at a somewhat higher level. Specifically, the budget increases support from \$15 million available to county offices for the first two years of the program to **\$10 million** in ongoing, annual funding beginning in 2006-07.

English Learner Set-Aside. The Governor's Budget does not continue a funding set-aside for the purchase of instructional materials that *supplement* the regular standards-aligned instructional materials schools purchase through the regular instructional materials program.

The 2004-05 budget provided a **\$30 million** set-aside that was available on a one-time basis over two years for the purchase of supplemental instructional materials to assist students in learning English. Supplemental materials purchased by schools had to be substantially correlated to both academic content standards and English Language Development standards.

The accompanying budget bill language for the 2004-05 set-aside specified that "the purpose of these materials will be to accelerate pupils as rapidly as possible towards grade level proficiency," and that the "funds shall be used to purchase supplemental materials that are designed to help English learners become proficient in reading, writing and speaking English."

The 2004-05 budget funded three limited-term positions to administer the \$30 million set-aside for English learner instructional materials. These positions expire at the end of 2005-06.

According to CDE, 650 school districts and county offices applied for, and received, the \$30 million in supplemental materials funding that resulted in providing approximately \$20 per English learner.

The Legislature provided another **\$20 million** in ongoing funding for purchase of supplemental materials for English learners in 2005-06; however, the Governor vetoed the funds for these purposes.

LAO Recommendation. The LAO recommends that the Legislature eliminate the **\$40 million** augmentation in Proposition 98 funds for instructional materials in 2006-07. This recommendation takes into account the **\$190 million** in instructional materials funding schools will receive from State Lottery funds in 2006-07.

The LAO recommends that the \$40 million in savings be scored as General Fund savings to address the state's budget deficit. If the Legislature chooses to retain these funds for schools, the LAO recommends redirecting the \$40 million toward implementation of reforms it suggests for the Economic Impact Aid program, as discussed at the April 24th Subcommittee hearing.

Comments: The State Board is currently working on updating the English/Language Arts curriculum framework, including the criteria for evaluating instructional materials submitted for adoption. These criteria guide the development of new instructional materials. A number of Senators have expressed strong concern to the Secretary for Education, Superintendent of Public Instruction and State Board of Education that the criteria recently approved by the State Board does not fully recognize the instructional materials needs for students who are English learners.

OUTCOMES: (1) Instructional Materials funding placed on "checklist", pending the May Revision.

(2) Subcommittee approved motion to remove funding for staff and support of the State Board of Education. (Vote 2-1)

II. California State Library (Item 6120)

The Governor's Budget proposes a total of \$74.7 million for the California State Library's operations and the various local assistance programs. Of that amount, \$48.1 million is from the General Fund, the remainder comes from other sources, including state special funds, federal funds, and bond funds.

Background. The California State Library provides library and information services to the legislative and executive branches of state government, members of the public, and California public libraries. In addition, the State Library administers and promotes literacy outreach programs, develops technological systems to improve resource sharing and enhance access to information, and administers the Public Library Foundation, which, via a statutory formula, distributes state funding to support basic services at local libraries.

California State Library				
<u>General Fund Budget Proposals</u>				
<i>(Dollars in Thousands)</i>				
	Revised	Proposed	Change	
	2005-06	2006-07	Amount	Percent
State Operations				
Support/operating budget	\$10,522	\$11,100	578	5.5%
Lease-revenue bonds	2,450	2,454	4	0.2%
Repairs for Sutro Library	17	17	0	0%
<i>Subtotals</i>	<i>\$12,989</i>	<i>\$13,571</i>	<i>582</i>	<i>4.5%</i>
Local Assistance				
California Civil Liberties Public Education Prog.	\$500	\$500	0	0%
California Newspaper Project	240	240	0	0%
California Library Services Act	14,342	14,342	0	0%
California English Acquisition & Literacy Prog.	5,064	5,064	0	0%
Public Library Foundation	14,360	14,360	0	0%
<i>Subtotals</i>	<i>34,506</i>	<i>34,506</i>	<i>0</i>	<i>0%</i>
Totals	\$47,495	\$48,077	582	1.2%

A. Public Library Foundation

Unlike prior years, the Governor's Budget proposes to hold constant, at \$14.4 million, the amount of funding available for the Public Library Foundation (PLF). This program provides core operational assistance to local libraries and is used to support library staffing, maintain hours of operation, develop and expand library-based programs such as after-school reading programs and homework assistance centers, and purchase books and materials.

This financial respite comes after four years of severe budget reductions. In 2000-01, the state appropriated \$56.9 million to the Public Library Foundation. Since then, local libraries have seen a rapid decline in support for the program, equating to an approximate 75 percent reduction over six years.

Staff recommends that the committee consider placing an augmentation for the Public Library Foundation on the "checklist" pending the May Revision. **OUTCOME: Unspecified amount of funding placed on the "checklist" pending the May Revision.**

B. Transaction-Based Reimbursement System

This program, which was designed to encourage libraries to cooperatively share their materials and resources with each other, uses state funds to reimburse local libraries for the costs associated with Direct and Indirect Loans.

Direct Loans. Currently, California residents may borrow books directly from any library in the state, regardless of where the individual resides. “Direct Loans” allow an individual to borrow materials from libraries outside the jurisdiction of their residence. As a local example, an individual may live in Auburn or Davis, but works in downtown Sacramento and, as a result, may find it easier to check out books from the Sacramento library. Over 28 million items are made available to borrowers annually through libraries where the borrowers do not reside.

Indirect Loans. Indirect loans allow individuals to borrow books from other libraries through an “interlibrary loan” program, where one’s hometown library requests a book on the borrower's behalf from another library anywhere in the state.

Direct loans (which lend materials to individuals) tend to be more prevalent in urban and suburban communities – communities where people work or attend school, while indirect loans tend to occur more predominately in rural communities where library holdings are more limited. Libraries are provided funding, via a reimbursement process, for the costs associated with these library loans. At present, this program is funded with \$12.5 million of General Fund – which represents approximately half the amount needed to fully compensate local libraries for their costs.

Staff recommends that the committee consider placing an augmentation for the Transaction Based Reimbursement System on the "checklist" pending the May Revision. **OUTCOME: Unspecified amount of funding placed on the "checklist" pending the May Revision.**

III. Capital Outlay

- A. **University of California (Item 6440).** The Governor's budget includes \$373.3 million in funding for 30 capital outlay projects spread across all ten UC campuses. With the exception of one project (discussed below), all projects are proposed to be funded with the proceeds of the 2006 General Obligation Bond Act, which is slated to go to the statewide ballot in November of 2006. These projects are included on the committee's consent agenda.

UC Santa Barbara: Education and Social Sciences Building. The Administration and UC are requesting that the committee authorize \$24.6 million in Lease-Revenue Bond funds for the construction phase of the Santa Barbara Education and Social Sciences Building. This proposal is contained in the Governor's *April 1, 2006 Finance Letter* to the Legislature.

Neither staff nor the Legislative Analyst has raised concerns with the project as a whole; however, both parties have expressed concern over the use of Lease-Revenue Bonds for this purpose. Given that the capital outlay portion of the budget proposal is predicated on the passage of a statewide General Obligation Bond measure, this project could be appropriated from that funding source. As a result, it may not be fiscally prudent for the committee to approve the financing of a \$24.6 million project at an interest rate traditionally higher than the rate of General Obligation Bonds.

Both UC and the DOF contend that, as part of the Legislature's negotiation of both the 2002 and 2004 Education Facilities Bond Acts, as contained in Assembly Bill 16 (Chapter 33, Statutes of 2002), the Legislature agreed to a funding "deal" whereby UC would provide an agreed-upon level of GO Bond support out of their allocation for Hastings College of Law, in exchange for a like-amount of additional Lease-Revenue Bonding authority for one of their projects. Given that this "deal" is neither documented nor readily recalled by Legislative staff, the committee may wish to simply consider if they are interested in using lease-revenue bonds as a funding mechanism for this project – regardless of whether there was an off-the-record agreement between various parties in 2002.

OUTCOME: Issue held open.

- B. **California State University (Item 6610).** The Governor's budget includes \$289.3 million in funding for 19 capital outlay projects spread across 14 CSU campuses. With the exception of one project (discussed below), the remaining projects are all included on the committee's consent agenda.

San Marcos: Social and Behavioral Sciences Building. The Governor's Budget includes \$1.1 million in funding from the proposed 2006 Education Facilities Bond to conduct preliminary plans for a new Social and Behavioral Sciences Building on the San Marcos campus. The project will provide 68,000 square feet of classroom, teaching laboratories, and 125 faculty offices. By approving \$1.1 million for preliminary plans, the Legislature will be approving the scope and future costs of the project, which are expected to total \$53.9 million.

The LAO has raised concerns with this project because it believes that the campus has excess capacity to accommodate an increase in student enrollments. Specifically, the LAO cites a new Academic II building slated to come online in 2006-07 which is expected to accommodate a 50 percent increase in enrollment. Furthermore, the LAO cites a decline in summer sessions enrollment to further illustrate that the existing facilities are underutilized. Since the LAO's analysis was released, CSU has provided data indicating that the campus is indeed enrolling students in the summer, but that the number of students served has declined from 2003 to present by approximately 18 percent. At the time of publication, the LAO's Analysis assumed that NO students were enrolled in the summer.

OUTCOME: Project approved "as budgeted" (Vote: 3-0)

- C. **California Community Colleges (Item 6870).** The Governor's budget includes \$585.7 million in funding for 70 capital outlay projects spread across 42 Community College districts. Neither Legislative Staff nor the LAO have raised direct concerns with any specific projects, all of which are proposed for consent. However, there is one significant issue to note: As part of the budget preparation process, the Community Colleges Chancellor's Office revised and updated their building cost guidelines which, until now, were last updated in 1993. These new cost guidelines were used to budget for capital projects proposed in the 2006-07 Budget and account for a significant increase in the budgeted cost of projects moving forward.
- D. **Overarching Issue (Information Only).** Throughout the 2006-07 capital outlay budgets of both the CSU and the Community Colleges, the LAO notes a series of price increases, which reflect a technical change in the way those institutions budget for construction costs. The change is due to a new set of cost guidelines issued by the Department of Finance and aimed at better budgeting and planning for the increased costs of construction. While this committee intends to approve capital outlay projects which are utilizing this new budgeting technique, it is staff's understanding that the overarching issue of how to better budget for rapidly changing capital outlay expenses, remains open, and will be discussed further by DOF and legislative staff and be resolved by future legislative action.

IV. California Student Aid Commission (Item 7980)

The Governor's 2005-06 Budget proposes a total of \$1.6 billion in expenditures (\$861.6 million General Fund) for the California Student Aid Commission, which reflects a \$60.1 million or a 3.8 percent increase above estimated current-year expenditures.

Figure 1

Student Aid Commission

Budget Summary^a

(Dollars in Millions)

	2005-06 Revised	2006-07 Proposed	Change	
			Amount	Percent
Expenditures				
Cal Grant programs				
Entitlement	\$645.0	\$697.2	\$52.2	8.1%
Competitive	115.5	118.2	2.7	2.4%
Pre-Entitlement	4.9	0.9	-4.0	-81.6%
Cal Grant C	9.2	9.6	0.4	4.4%
<i>Subtotals—Cal Grant</i>	<i>\$774.6</i>	<i>\$825.9</i>	<i>\$51.3</i>	<i>6.6%</i>
APLE ^b	\$40.9	\$47.7	\$6.8	16.7%
Graduate APLE	0.4	0.4	—	—
Law enforcement scholarships	0.1	0.1	—	—
Totals	\$816.0	\$874.2	\$58.2	7.1%
Funding Sources				
General Fund	\$752.4	\$861.6	\$109.2	14.5%
Student Loan Operating Fund ^c	51.0	—	-51.0	-100%
Federal Trust Fund ^d	12.6	12.6	—	—

a

In addition to the programs listed, the commission administers the Byrd Scholarship and the Child Development Teacher and Supervisor programs—both of which are supported entirely with federal funds. It also administers the Student Opportunity and Access program, an outreach program supported entirely with Student Loan Operating Fund monies.

b

Assumption Program of Loans for Education.

c

These monies pay for Cal Grant costs as well as support and administrative costs.

Specifically, the Governor's Budget proposes an increase of \$51.3 million (6.6 percent) over the current year expenditures for the Cal Grant Program. Following are the adjustments to the Cal Grant Program as proposed by the Governor: (1) increase the total number of Cal Grants entitlement awards available (by 4,300 for a total of 268,210 new and renewal grants) based on new estimates of eligible high school graduates, transfer students and renewal applicants (\$39.5 million); and (2) increase the maximum Cal Grant award level for students attending private institutions (\$11.9 million).

Other adjustments to the Student Aid Commission's budget include a \$6.8 million increase in the funding available for the Assumption Program of Loans for Education Program (APLE). This funding adjustment is needed to cover the loan-forgiveness costs associated with previously-issued

warrants. In addition, the Governor proposes to issue 8,000 new APLE warrants in 2006-07, the same number as authorized in the current year. Of the 8,000 new warrants, the Governor proposes to "set-aside" 600 warrants specifically for students participating in the UC and CSU Math and Science Teacher Initiative.

In addition, the Administration's budget proposal implements the National Guard APLE program, which offers loan forgiveness to individuals who enlist or re-enlist in the National Guard, State Military Reserve and/or Naval Militia by authorizing the issuance of 100 new warrants which would not require funding until a future year.

A. Proposed Increase to Maximum Cal Grant Award for Private College Students

The Governor proposes to augment the Cal Grant budget by \$11.9 million to increase the grant level for students attending private and independent colleges by 16.5 percent. This would result in the maximum grant level being increased from the current amount of \$8,322 to \$9,708. The Governor's proposal would only impact new Cal Grant recipients; students currently receiving awards would retain their current-valued grant.

Between 2003-04 and 2004-05, the maximum Cal Grant award level for students attending private colleges and universities decreased by \$1,376 (14 percent), from an annual award level of \$9,708 to the current level of \$8,332. This proposal by the Governor would take the Cal Grant back to its pre-2003 level.

LAO Recommendation. In response to the Governor's proposal, the LAO recommends that the Legislature adopt a statutory policy to link the award level for a private university Cal Grant to the amount of the General Fund subsidy the state provides to financially-needy students attending the University of California (UC) and California State University (CSU). At present, Assembly Bill 358 (Liu) is making its way through the legislative process and seeks to encompass many of the changes recommended by the LAO. Staff notes that prior to the implementation of the current Cal Grant entitlement program (Chapter 403, Statutes of 2000), state law provided for annual adjustments to the private college grant amount based on the state support provided per student to the UC and CSU.

If the LAO's policy was enacted for the coming fiscal year, it would raise the maximum grant amount to \$11,011, costing the state an additional \$11.1 million over the amount provided in the Governor's Budget.

Staff recommends that the committee approve this issue "as budgeted". **OUTCOME:** Issue held Open Pending the May Revision.

B. National Guard Assumption Program of Loans for Education (APLE)

The National Guard APLE program was established in statute in 2003 (Chapters 345, Statutes of 2003), but to-date the Student Aid Commission has not been provided with either the authority to issue warrants nor the funds to administer the program. The Governor's Budget seeks to fund this new program by proposing that 100 new loan forgiveness warrants be authorized in 2006-07.

The issue for the subcommittee to consider is: *During difficult fiscal times, is it the priority of the legislature to provide monetary support for a loan forgiveness program that seeks to encourage students to enlist in the National Guard, State Military Reserve or the Naval Militia?*

OUTCOME: Issue held open pending the May Revision.

C. Assumption Program of Loans for Education (APLE)

The Governor's budget authorizes 8,000 new APLE loan assumption warrants (the same number as authorized in the current year); however, the Governor proposes directly allocating 600 of these warrants to the UC and CSU for those institutions to award to students participating in UC's and CSU's Math and Science Teacher Initiative.

As part of last year's May Revision, the Governor recommended a similar "set-aside" of APLE warrants for the UC/CSU Math and Science Teacher Initiative. The committee denied the Governor's proposal to establish a new APLE program for the Math and Science Teacher Initiative participants, and instead expressed that priority for 300 new APLE warrants be given to individuals training to become math, science, and special education teachers, regardless of the institution they are attending. The intent of the language was to recognize the special need for math and science teachers, but to meet this need within the confines of the existing APLE program, instead of developing either a new loan assumption program or fragmenting the existing APLE program. Further, the language sought to acknowledge that math and science teachers are produced from a variety of institutions, not just the UC and CSU.

The concerns raised by staff and the LAO a year ago, remain unchanged today. Specifically, there is no evidence to suggest that the existing APLE program (in its current format) cannot meet the needs of the state in recruiting and retaining new Math and Science teachers. Further, both staff and the LAO expressed concern that a set-aside of awards will only create confusion for students and administrators. In addition, the development of a new APLE program, or a set-aside within the existing program has traditionally been viewed as a policy issue that should be contained in separate legislation.

In response, the UC and CSU believe that having 600 loan assumption warrants at their disposal is critical to recruiting their students to become math and science teachers, and critical to the ultimate success of their Math and Science Teacher Initiative. They believe that students participating in their Initiative will likely have higher completion rates in both the teacher preparation programs and their math/science teaching commitment. Further, DOF notes that annually, the 8,000 new APLE warrants are underutilized. Specifically, DOF cites the underutilization of existing statutory APLE "set-asides", which are aimed at accommodating K-12 district interns and out-of-state teachers. However, according to the LAO, these unused warrants are eventually re-directed back to college campuses where they are ultimately used by students.

Staff recommends that the committee approve the proposed 8,000 APLE warrants; deny the Administration's request to set-aside 600 warrants for UC and CSU students; and adopt language giving students intending to become math and science teachers (regardless of the institution they

attend) "priority" within the existing APLE program. **OUTCOME:** Issue held open pending the May Revision.

D. State Nursing - Assumption Program of Loans for Education (SNAPLE)

As part of the current year budget trailer bill, the Legislature established the State Nursing - Assumption Program of Loans for Education and authorized the issuance of 100 new loan assumption warrants, and \$100,000 and one position to administer the program.

The intent of SNAPLE is to encourage individuals to complete their graduate-level education in nursing and serve as nursing faculty at accredited California colleges and universities. Similar to the APLE program, the state forgives a specified amount of student loan debt for each year a SNAPLE participant teaches nursing. Under this program, the state will assume up to \$25,000 in outstanding student loans if the participant teaches nursing for three consecutive academic years.

The Governor's Budget includes language requiring the Student Aid Commission to issue a report, by April 1, 2007, on the SNAPLE program, but fails to provide authority for the Commission to issue new SNAPLE loan assumption warrants. DOF indicates that it believed the program to be one-time in nature. However, staff notes that was not the intent of the Legislature (as evidenced by the (1) the program's inclusion in statute -- as opposed to budget bill language; (2) the Legislature's addition of one position, on an ongoing basis, to administer the program; and (3) specific language in statute expressing the intent of the Legislature that funding be provided for the program within the annual budget act.) Further, staff notes that DOF, in its final "scoring" of the Legislature's budget actions (through the Change Book system), did not identify this program as one-time in nature.

According to the Student Aid Commission, the SNAPLE program has had a slow start. The Commission is currently in the process of promulgating regulations through the Office of Administrative Law, and will likely not issue any of the 100 authorized warrants in the current year. Given that those warrants were authorized for the 2005-06 fiscal year, the authority will simply expire as of June 30, 2006.

Staff recommends that the Legislature continue the program into 2006-07 by authorizing the issuance of 100 new SNAPLE loan assumption warrants in the Budget Act. **OUTCOME:** Issue held open pending the May Revision.

E. Public Interest Attorney Loan Repayment Program

Current statute establishes the Public Interest Attorney Loan Repayment Program to encourage licensed attorneys to practice in public interest areas of law, which includes, but is not limited to, legal services organizations, prosecuting attorney's offices, child support agency offices, and criminal public defender's offices. Similar to the APLE program, the state forgives a specified amount of student loan debt for each year a Public Interest Attorney practices law in specified arenas. Under this program, the state will assume up to \$11,000 in outstanding student loans if the participant practices public interest law for four years. While this program has been "on the books" since established by the Legislature in 2001, it has yet to become operational due to an absence of state funding and authority for the Student Aid Commission to issue loan assumption warrants.

Since 2001, the cost of receiving a legal education has increased dramatically, as student fees and educational costs have risen. As an example, in 2001 a resident student attending Hastings College of Law paid \$11,232 annually in student fees, compared with \$22,297 in the current year. Faced with increasing debt burdens, many law school graduates are financially unable to choose public interest law due to the lower-paying salaries inherent in those positions.

Staff recommends that the committee *consider* providing start-up costs for the program, including one position and \$100,000 to promulgate regulations and begin implementing the Public Interest Attorney Loan Repayment Program. **OUTCOME:** Issue held open pending the May Revision.

F. EdFUND Organizational Issues (Information Only)

Background. Operating under California statute, EdFUND is a nonprofit "auxiliary" organization of the California Student Aid Commission which administers the Federal Family Education Loan Program (FFELP) on behalf of the state. Student loans under the FFELP are guaranteed by the federal government in order to ensure that lenders themselves do not bear the risk associated with lending money to students (who traditionally have no credit or payment history) and that students don't "pay" for this increased risk in the form of high loan fees and interest rates. In addition to FFELP, the federal government also operates a Direct Lending program which places the federal government in the role of both lender and guarantor by directly lending money to students via their educational institutions.

Colleges and universities which offer student loan programs have a choice between a variety of FFELP "guarantors" (EdFUND is only one of several guarantee agencies in the country) or the federal Direct Lending program. In the mid-1990s, the Legislature and the Governor explicitly granted the Student Aid Commission's request to statutorily establish EdFUND, freeing the organization of state bureaucratic constraints, so that it could actively participate in the competitive student lending and guarantee marketplace.

1. Structural Options for Administering the FFELP.

As part of its 2005-06 Budget deliberations, this committee requested the LAO to identify a range of structural options available to the Legislature for providing the state with access to federally-guaranteed student loan services.

The LAO issued the requested report in January, citing five basic structural options for administering – or coordinating the administration of – the federal student loan programs. As part of its *Analysis of the 2006-07 Budget Bill*, the LAO continued its work in this area by recommending that the Legislature enact legislation to restructure the state's administration of financial aid programs into a single, nonprofit, public benefit corporation, that would be subject to strong state accountability requirements.

2. Bureau of State Audits: Changes in the Federal Family Education Loan Program.

Last Spring, the Joint Legislative Audit Committee requested that Bureau of State Audits conduct an audit of the California Student Aid Commission's (CSAC) administration of the Federal Family Education Loan Program (FFELP).

In summary, the Bureau of State audits found that: (1) recent changes in federal law raise doubts about the ability of the state to sustain its administration of the program; (2) ongoing tensions between the Student Aid Commission and EdFUND have hampered the State's ability to renegotiate a revenue agreement (known as the Voluntary Flexibility Agreement – VFA) thereby jeopardizing at least \$24 million in federal revenues; (3) tensions have further hampered and delayed attempts to expand and diversify the services offered by EdFUND; (4) the Student Aid Commission approved bonuses for EdFUND employees in years when the program was operating in a deficit; and (5) the Student Aid Commission has not maintained adequate oversight over EdFUND.

a) Status of California Voluntary Flexible Agreements (VFA)

One of the most crucial fiscal issues uncovered by the Bureau of State Audits (BSA) concerned the negotiation of the state's Voluntary Flexible Agreements (VFA) with the United States Department of Education (USDE).

In 1998, amendments to the Higher Education Act of 1965 gave USDE the authority to negotiate VFAs with individual guaranty agencies. Those guaranty agencies with VFAs receive waivers from certain federal laws and regulations in exchange for meeting specified performance outcomes, all of which are negotiated on a state-by-state basis. The overarching intent of the VFA process is to improve FFELP by encouraging experimentation and sharing of best practices among guaranty agencies. More specifically, VFAs are intended to shift the focus from collecting on defaulted student loans (the emphasis of the standard guaranty agency model) to improving outreach, default prevention, and loan servicing. Currently, five guaranty agencies, including CSAC, have VFAs.

The BSA found that ongoing tensions between the Student Aid Commission and EdFUND resulted in a significant delay in renegotiating California's 2004-05 VFA, which, for that

federal fiscal year, resulted in the loss of at least \$15 million in revenue from the federal government.

While negotiations for the 2005-06 VFA appear to be on track, staff notes that USDE has yet to approve the agreement, although USDE has expressed its willingness to make an approved agreement retroactive to October 2005 (the start of the federal fiscal year). In any given fiscal year, these VFAs could result in up to \$30 million in funding from the federal government. Staff recommends that the Legislature continue closely monitoring the progress of the Student Aid Commission and EdFUND in successfully negotiating a VFA.

b) Assessment of a Default Fee on Student Loans

Recent changes in federal law now require FFELP guaranty agencies (including EdFUND) to charge borrowers a one percent federal default fee on the principal amount of all FFELP loans issued after July 1, 2006 and deposit the proceeds of the fee into the Federal Fund. The assessment of this fee was designed to increase the amount of federal funding that guaranty agencies held in reserve, thus decreasing the federal government's fiscal liability for the program.

Guaranty agencies in exceptional financial health have expressed their intent to waive the fee for student borrowers, thereby "backfilling" the fee revenue with their own resources. EdFUND, whose financial reserves have declined significantly, has determined that it will waive the fee for borrowers from July 1, 2006 through October 1, 2006 -- which constitutes the period of time during which the bulk of the student loan activity occurs -- and then begin charging borrowers the one percent fee after October 1, 2006. The Student Aid Commission and EdFUND state that, had the Legislature and Administration NOT used EdFUND revenues to support the Cal Grant program in recent fiscal year, the state may have had the resources to waive the one percent fee beyond the October 1, 2006 date.

Staff recommends that the Legislature continue to closely monitor the assessment of the default fee on student borrowers as well as the fiscal stability of EdFUND.

V. PROPOSED CONSENT (OUTCOME: Approved 3-0, unless otherwise noted)

Staff recommends that the following items be Approved as Budgeted.

1. Item 6120-011-0001 State Operations, California State Library. \$10,880,000
2. Item 6120-011-0001 State Operations, California State Library. Addition of two Information Technology Positions, per Governor's Budget proposal. \$220,000
(OUTCOME: Approved 2-1)
3. Item 6120-011-0020 State Law Library, California State Library. Payable from State Law Library Special Account. \$548,000

4. Item 6120-011-0890 Support, California State Library. Payable from the Federal Trust Fund. \$6,832,000
5. Item 6120-011-6000 Support, California State Library. Payable from California Public Library Construction and Renovation Fund. \$2,755,000
6. Item 6120-011-6029 Support, California State Library, California Cultural and Historical Endowment. \$1,718,000
7. Item 6120-012-0001 Support, California State Library, Debt Service. \$2,454,000
8. Item 6120-013-0001 Support, California State Library, Sutro Library Special Repairs. \$17,000
9. Item 6120-150-0001 Local Assistance, California State Library, California Civil Liberties Public Education Program. \$500,000
10. Item 6120-151-0483 Local Assistance, California State Library, Telephonic Services. Payable from the California Deaf and Disabled Telecommunications Program, Administrative Committee Fund. \$552,000
11. Item 6120-160-0001 Local Assistance, California State Library, California Newspaper Project. \$240,000
12. Item 6120-211-0001 Local Assistance, California State Library, Library Development Services. \$14,342,000
13. Item 6120-211-0890 Local Assistance, California State Library, Library Development Services. Payable from the Federal Trust Fund. \$12,518,000
14. Item 6120-213-0001 Local Assistance, California State Library, California English Acquisition and Literacy Program. \$5,064,000
15. Item 6420-001-0001 Support, California Postsecondary Education Commission. \$2,065,000
16. Item 6420-001-0890 Support, California Postsecondary Education Commission, payable from the Federal Trust Fund. \$437,000
17. Item 6420-101-0890 Local Assistance, California Postsecondary Education Commission, payable from the Federal Trust Fund. \$8,579,000
18. ~~Item 6440-301-0660 Capital Outlay, University of California, pursuant to April 1, 2006 Finance Letter, remove Berkeley campus project from Item.~~

19. ~~Item 6440-301-6041 Capital Outlay, University of California, add item per April 1, 2006 Finance Letter to appropriate (1) \$15,319,000 for construction of San Francisco Campus Medical Sciences Building Improvements; and (2) 49,706,000 for construction of Santa Barbara campus Education and Social Sciences Building project.~~
20. ~~Item 6440-301-6048 Capital Outlay, University of California, specified projects, per attached.~~
21. ~~Item 6440-302-6048 Capital Outlay, University of California, specified projects, per attached.~~
22. ~~Item 6440-401 Capital Outlay, University of California. Budget Bill Language~~
23. ~~Item 6440-495 Reversion, University of California, add item per April 1, 2006 Finance Letter to revert funding for the following projects: (1) San Francisco Campus, Medical Sciences Building Improvements, Phase 2 Construction; (2) Berkeley Campus, Giannini Hall, Seismic Safety corrections; (3) Santa Barbara Campus, Education and Social Sciences Building, Construction;~~
24. Item 6610-001-6048 Support, California State University, payable from 2006 Bond Fund.
25. Item 6610-301-6028 Capital Outlay, California State University, add item per April 1, 2006 Finance Letter to appropriate \$42,252,000 for the construction phase of the Chico Student Services Center project.
26. Item 6610-301-6041 Capital Outlay, California State University, payable from the 2004 Bond Act. Specified projects, per attached.
27. Item 6610-301-6048 Capital Outlay, California State University, payable from the 2006 Bond Act. Specified projects, per attached.
28. Item 6610-302-6041 Capital Outlay, California State University, payable from the 2004 Bond Act. Specified projects, per attached.
29. Item 6610-302-6048 Capital Outlay, California State University, payable from the 2006 Bond Act. Specified projects, per attached.
30. Item 6610-401 Capital Outlay, California State University.
31. Item 6610-496 Capital Outlay, Reversion, California State University, add item per April 1, 2006 Finance Letter to revert funding and authority for Chico Campus, Student Services Center.

32. Item 6870-301-0574 Capital Outlay, California Community Colleges, payable from the 1998 Bond Act. Specified projects, per attached.
33. Item 6870-303-0574 Capital Outlay, California Community Colleges, payable from the 1998 Bond Act. Specified project, per attached.
34. Item 6870-301-6028 Capital Outlay, California Community Colleges, payable from the 2002 Bond Act. Specified projects, per attached.
35. Item 6870-301-6028 Capital Outlay, California Community Colleges, *Revise item, per April 1, 2006 Finance Letter to appropriate \$24,392,000 for construction and equipment phases of the Cuesta College Theater Arts Building.*
36. Item 6870-301-6041 Capital Outlay, California Community Colleges, payable from the 2004 Bond Act. Specified projects, per attached.
37. Item 6870-301-6041, Budget Act of 2005 Capital Outlay, California Community Colleges, *Rescope Merced College Leshar Building Remodel Project, per April 1, 2006 Finance Letter.*
38. Item 6870-303-6041 Capital Outlay, California Community Colleges, payable from the 2004 Bond Act. Specified project, per attached.
39. Item 6870-301-6048 Capital Outlay, California Community Colleges, payable from the 2006 Bond Act. Specified projects, per attached.
40. Item 6870-301-6048 Capital Outlay, California Community Colleges, payable from the 2006 Bond Act. *Revise item, per April 1, 2006 Finance Letter as follows: (1) Augment by \$3,289,000 Merced College Allied Health Center project; and (2) Decrease by \$34,927,000 to reflect scheduling change with San Francisco campus – Phelan Campus project.*
41. Item 6870-303-6048 Capital Outlay, California Community Colleges, payable from the 2006 Bond Act. Specified projects, per attached.
42. Item 6870-490 Capital Outlay, Reappropriation, California Community Colleges. *Add item per April 1, 2006 Finance Letter to reappropriate \$300,000 for Mt. San Antonio College Seismic Retrofit and amend the scope of the project.*
43. Item 6870-491 Capital Outlay, Reappropriation, California Community Colleges. *Add item per April 1, 2006 Finance Letter to reappropriate \$1,036,000 for San Francisco City College – Phelan campus working drawings.*
44. Item 6870-497 Capital Outlay, Reversion, California Community Colleges. *Add item pursuant to April 1, 2006 Finance Letter to revert \$11,665,000 for Cuesta College Theater Arts Building.*

- 45. Item 7980-001-0784 State Operations, California Student Aid Commission.
Decrease item by \$199,000 per April 1, 2006 Finance Letter
- 46. Item 7980-001-0784 State Operations, California Student Aid Commission.
\$13,879,000
- 47. Item 7980-001-0784 State Operations, California Student Aid Commission.
\$1,569,000 and 2.4 positions for the Cal Grant Delivery System
- 48. Item 7980-101-0890 Local Assistance, California Student Aid Commission.
\$12,583,000.
- 49. Item 7980-495 Reversion, California Student Aid Commission.